Attachment 1

WILSHIRE CONSULTING

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September 2, 2008

Ms. Anne Stausboll
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400 P Street, Suite 3492
Sacramento, CA 95814

Re: International Equity Contract Renewal Recommendation[1]

Dear Anne,

You requested Wilshire's opinion with respect to Staff's recommendation pertaining to the annual review and renewal of the contracts of the international equity managers. Wilshire concurs with Staff's recommendations and our comments regarding all 18 active and enhanced international equity managers are below.

Recommendation and Discussion

During the 2008 fiscal year, the CalPERS' International Equity manager program underperformed its benchmark by 0.42%, continuing the decline observed in 2007 (-0.13%) and continuing to reverse the successes of FY 2006 (1% ahead) and FY 2005 (2% ahead). This underperformance resulted from poor performance by all three main types of international managers – active international managers underperformed by 74bp, enhanced index international managers underperformed by 89bp, and active emerging markets managers underperformed by 14bp.

We note that the emerging markets managers as a whole have outperformed over the past 5 years by an annualized 1.06%, but have steadily underperformed since the Investment Committee terminated the permissible markets report. Although we do not blame the recent underperformance solely on the newly permitted markets, some underperformance (both relative to the benchmark and relative to similar mandates without the Permissible Country restriction) was previously attributed to the restrictions imposed by the Permissible Countries list. The elimination of the restriction has not made an immediate impact on the performance of the emerging markets managers.

[1] Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover and is included as an attachment to this agenda item.

We also note that Staff is currently in the process of restructuring the entire domestic and international manager line-up, terminating several managers and funding several others out of the spring-fed pools. Since March 1, external international equity managers have added 0.77% of value above the benchmark. This time period is too short to draw any meaningful conclusions about the success or failure of the new list of managers, but it is certainly a positive start.

We support the annual contract renewal recommendation as the current stable of managers has outperformed since inception, and only slightly underperformed in the two most recent fiscal years. Staff has the authority to terminate managers who do not perform as expected, and they have used that authority when necessary and appropriate. The renewal of these contracts does not in any way preclude Staff from exercising the authority to terminate any manager who ceases to perform as expected subsequent to contract renewal.

In addition, as Staff is currently wrapping up its “fresh look” at the entire Global Equity portfolio and asset class structure, we believe that it is prudent to renew the contracts for all managers to give Staff time to determine what the structure of this portfolio should be in the future.

Acadian Asset Management

Acadian actively manages an All Country World ex-US portfolio for CalPERS that employs a quantitative process for all stock, sector, country, and currency research, and for portfolio construction and management. Acadian models more than 20,000 stocks in more than 60 markets, and builds portfolios that typically contain 150 to 200 stocks. Multiple on-site reviews of this company conducted by Wilshire (including members of CalPERS’ consulting team) over the last few years have showed us that this manager employs one of the most advanced investment processes in the industry. The manager was hired in December 2005 and initially built a strong track record with CalPERS, outperforming in the first 5 of 6 quarters. Unfortunately, the last two quarters of calendar 2007 were characterized by large underperformance by most quantitative managers. As the credit crunch began to impact the market in July, 2007, rapid delevering by a number of hedge funds, investment banks, and quantitative managers resulted in poor performance for most quantitative enhanced managers. As a result, Acadian underperformed by 3.37% for the fiscal year but had a strong performance since the market began to level out. We believe this is a top manager, and the year’s poor performance is an anomalous event.

AllianceBernstein

AllianceBernstein manages three non-US equity portfolios for CalPERS. The first is the Bernstein Emerging Markets Value Portfolio. Unlike many emerging markets managers who pick a variety of large cap "core" stocks with a few growth and value stocks, this portfolio seeks out the deepest value companies in the emerging markets, using Bernstein's typical in-depth fundamental research and valuation process. As a result, this portfolio represents the analysts' and portfolio managers' highest conviction ideas. This manager was hired in 2002 and had outperformed by 165bp to 1565bp in each of its first four years, but underperformed for the first time in fiscal 2006 by 335bp mainly due to some poor sector choices and in fiscal 2007 by 1.44% due to the strong value bias in an overwhelmingly growth-oriented market. We believe that the strong performance since inception (379bp ahead) more than compensates for the past two year's results and we recommend allowing this manager time to get back on track. If growth stocks continue to outperform value stocks, as has been the case for the last two quarters, improvement may take slightly longer to realize, given the portfolio's value bias.

AllianceBernstein also manages large cap growth and value international equity portfolios for CalPERS, benchmarked to the All Country World ex-US index. The two portfolios are essentially mirror images of each other, holding 50 to 75 growth or value stocks. Both portfolios seek to add value over the benchmark primarily through stock selection, with only incidental value added or lost through country or sector positions. Given the growth and value biases of these portfolios, they should be expected to have divergent performance in short periods, but to outperform the broad benchmark over a long-term market cycle. Since the managers were hired in September 2005, their performance has, indeed, offset each other. Value stocks outperformed growth for the first 2 years or so, and then growth stocks dramatically outperformed over the last 18 months. This market environment has been reflected in the performance of these two portfolios, with the growth portfolio adding 6.27% over the benchmark for fiscal 2007 and the value portfolio underperforming by 10.56%. Since inception, the growth portfolio is just slightly ahead of the benchmark (0.05% ahead) and the value portfolio lags by 2.36%. Although the performance of neither portfolio is especially convincing since inception, we believe that in the volatile market we have experienced over the last few years, with large swings between growth and value investing, these two concentrated portfolios have performed generally as expected.

AQR Capital Management

AQR combines the concepts of value and momentum to capitalize on the overreactions of other investors in the marketplace to news and mass psychology. The manager uses a series of proprietary global asset allocation and security selection models to affect its investment process. Beyond pure stock selection, the manager also incorporates an industry relative ranking system that feeds back into the security ranking and selection process. This manager was hired in December 2005, and underperformed the benchmark by 157bp in the first two quarters of management for CalPERS in fiscal 2006, added 56bp of outperformance in fiscal 2007, but underperformed by another 1.70% for fiscal 2008. Although the since inception performance of -1.21% is well-below expectations, we believe that much of the poor performance in the second half of calendar 2007 is explained by the same factors that influenced Acadian's performance. In fact, since March, as many quantitative and enhanced managers have bounced back, AQR has added 2.68% above the benchmark.

Arrowstreet

Arrowstreet was hired in March 2003 to manage a core-oriented All Country World ex-US portfolio for CalPERS. Arrowstreet seeks to take advantage of both behavioral mispricings (value, momentum, technical signals) and informational mispricings (earnings signals), profiting when most investors in the market respond to some new piece of information in a biased, slow, or inefficient manner. Arrowstreet utilizes opportunistic biases (value/growth, large/small, world regional) away from the benchmark as its signals indicate, but will not maintain such biases in a systemic or permanent fashion. Over the last four fiscal years, the manager outperformed by 7% in fiscal 2005, by 1.4% in fiscal 2006, by 4% in fiscal 2007, and by 1.51% in fiscal 2008. Since inception with CalPERS, the manager has beaten the benchmark by an annualized 125bp of value-added.

AXA Rosenberg

AXA Rosenberg has managed a core European equity portfolio for CalPERS since March 2001. AXA employs a quantitative strategy where the true value of each of 19,000 stocks is recalculated every three minutes, and the portfolio is subsequently optimized based on the results of any changes. Unlike many quantitative managers who employ a multi-factor model which is based on independent assumptions of what makes a stock cheap or expensive, AXA's models price each security based on what the market is paying for such securities. For example, the consumer software portion of Microsoft is valued based on where the market is valuing all the other consumer software companies (or the portions of other companies that contain consumer software divisions), and then is added to the business software's valuation based on the current market valuation for business software companies. To the extent that the computed total valuation differs from the current stock price, AXA's models indicate whether the stock should be bought or sold. An equally quantitative methodology is used to predict the future earnings of companies, and this forecast is combined with the valuation model to construct a portfolio of stocks with index-like characteristics but superior projected growth and current valuation. Despite the underperformance of quantitative managers in 2008 in general, AXA was one of the top-performing quantitative managers in the industry, adding 69bp of outperformance above the benchmark. This manager has outperformed in each of the last 5 fiscal years, and has added an annualized 1.96% outperformance since inception.

Baillie Gifford

Baillie Gifford manages an active international equity portfolio for CalPERS that exhibits a growth orientation. This portfolio was one of two which were noted by Wilshire in September 2005 for observation, but it has had a significant improvement in performance in the three years since then. The manager seeks to add value by constructing a portfolio of roughly 100 to 150 names utilizing a bottom-up stock selection process. The stock selection is performed by regional teams and then the overall regional allocation is determined by an Investment Policy Committee. Performance improved greatly during the 2005 fiscal year as the manager made improvements on overall portfolio construction during the regional allocation process. These improvements continued to reap rewards in fiscal year 2006, with the portfolio reporting an excess return of 7.44%, slightly better-than-benchmark performance in fiscal 2007, and tremendous performance in fiscal 2008 of 9.11% outperformance, at least partly due to the manager's moderate growth bias. Since inception, the manager has had positive performance since inception of 221bp.

Batterymarch Financial Management

Batterymarch manages an emerging markets portfolio for CalPERS and was first funded on June 1, 2007. The manager uses a quantitative screening and evaluation process to determine which stocks are fundamentally sound enough to include in their computer-optimized portfolio. Although the manager does not seek to replicate index characteristics overall, as do many of the other managers in this program, Batterymarch uses their optimizer to construct the best portfolio on the basis of a number of risk factors, such as country exposure, size bias, etc. Since inception (13 months ago), the manager's approach has worked well, outperforming the benchmark by an annualized 3.61%.

Dimensional Fund Advisors

DFA has managed an Emerging Markets portfolio for CalPERS since August 2002. DFA's investment process uses quantitative screens first to identify the most liquid stocks and then to determine which stocks have superior valuation. Country weightings are based on market capitalization and liquidity. There is no specific level of tracking error targeted, but individual positions are usually limited to 4% of the portfolio's value. Much of the firm's value added comes through superior trading of positions, and the firm has made a large investment into the systems and personnel required to execute its strategy. Since hiring DFA, CalPERS' portfolio has experienced positive relative returns in five of the last seven years, with the exceptions being a 5% underperformance in fiscal year 2006 and 2.1% underperformance in fiscal 2008, when, as was previously mentioned, quantitative strategies underperformed in general. Since inception, despite the poor performance in two of the last three years, DFA has still outperformed by an annualized 1.83%.

Genesis Asset Management

Genesis manages an Emerging Markets portfolio for CalPERS and was retained in August 2002. Genesis employs a fundamental research-based investment process which pools the joint resources of ten country specialists. The portfolio is constructed with little regard for the benchmark, and is based on the team's opinion of each of the roughly 300 companies which are monitored and modeled. Since inception, Genesis has underperformed the benchmark by an annualized 91bp, largely due to a significant underperformance of 7.97% in fiscal 2007. Given the manager's concentrated positions and lack of reliance on the index, the portfolio has been volatile relative to the index (the manager outperformed by 6.52% in fiscal 2005), and Staff and Wilshire reported last year that they will monitor this manager closely to be sure that the fiscal 2007 performance does not persist. I conducted an on-site visit with Genesis in London in May 2008 and have grave concerns in this manager's ability to add value for CalPERS going forward. Wilshire and Staff have had several discussions about the role of this manager in the portfolio going forward and we believe those discussions will reach a conclusion in short order. In the meantime, Wilshire recommends renewing this contract in order to not disrupt the remainder of the emerging markets portfolio and potentially subject CalPERS to onerous transaction costs. We will continue to monitor this manager and will make appropriate recommendations as necessary.

Grantham, Mayo, Von Otterloo

GMO has managed a core All Country World ex-US portfolio for CalPERS since June 2001. GMO's investment process derives roughly 65% of its value from stock selection and 35% from country selection. The manager starts with a screen to identify stocks with superior valuation, and then uses a combination of both quantitative analysis and qualitative research to determine which stocks should be in the portfolio. The country decision is based on the comparative valuation one country has versus others. As a result of all of these processes, the resulting portfolio will have a moderate value bias over time. Since inception, the portfolio has added annualized value of 2.17%, but has underperformed in the last four fiscal years by 64bp, 111bp, 94bp, and 331bp. GMO tends to take macroeconomic positions before much of the rest of the industry, preferring to be early than late. Performance over the last four years has suffered as the firm anticipated a decline in commodities prices in 2005 and began positioning for the drop in 2005-2006, which obviously was not a successful position. Wilshire and Staff will continue to monitor this manager over the next year. Although we believe that this is a talented manager in general, the poor performance over the past four years leads us to believe that Staff may be better served by placing these assets elsewhere as the rebalancing of the external managers continues.

Lazard

Lazard was retained by CalPERS on August 1, 2007 to manage an active emerging markets equity portfolio. Lazard manages assets using a fundamental-based relative value investment approach, employing a bottom-up investment strategy that incorporates macro-economic, political, and corporate governance risks in a unique and disciplined approach. The team aggregates a variety of risk calculations to require each stock have an expected return of at least 20% and then invests in a fairly concentrated portfolio of 60-90 of the best ideas. In the first fiscal year, the manager got off to a great start and outperformed the benchmark by 3.19%.

New Star

New Star was retained by CalPERS in October 2005 to manage a portfolio benchmarked to the All Country World ex-US index. The firm employs a research-driven, fundamental process to identify companies with superior management and growth prospects. Ultimately, the portfolio has a slight growth tilt. The research process closely analyzes each firm's competitive position, quality of management, and ability to increase shareholder value. The firm also makes use of macro-economic data, such as real money flows, to determine which countries and sectors are best positioned for future growth. Since inception for CalPERS, the manager has lost 2.02% relative to the benchmark, and underperformed by 1.47% in fiscal 2008. We will continue to monitor this manager for signs of improvement. As with GMO, the continuous negative performance warrants a close examination by Staff and a possible move to other managers as the rebalancing continues, especially considering that the manager's growth bias should have provided a performance tailwind over the past year.

Nomura

Nomura was hired in August 1989 to manage a Pacific Basin portfolio for CalPERS and has the longest tenure of any manager in the portfolio. The portfolio management process flows top-down, with a macro-economic ranking of each country in the Pacific Basin for attractiveness comprising the first step. Sector allocation forms the next major step in the investment process, with local country teams aggregating the results of their stock analysis into sector forecasts which then drive the sector allocations. Finally, each local team of portfolio managers selects the stocks that will go in the portfolio on the basis of a number of metrics (including P/E, P/CF, and P/B) per the constraints imposed by the sector allocation process. This portfolio has added value for CalPERS in five of the last seven years, and has generated annualized performance of 4.10% since inception, adding 24bp of outperformance in fiscal 2008.

Pictet Asset Management

Pictet manages an emerging markets portfolio for CalPERS and was first funded on June 1, 2007. This manager is value-biased and employs a quantitative screening methodology to select stocks for inclusion in the portfolio. Country and sector weights result from stock selection, although subsequent risk controls help to mitigate the effects of large unwanted biases in the portfolio. In the first 13 months since this manager was hired, it has had strong performance, returning an annualized 3.66% of value-added.

Pyramis Asset Management

Pyramis manages an international equity portfolio for CalPERS that invests in the best ideas from Pyramis' pool of analysts around the world. The portfolio management team looks at the internal rankings of stocks assigned by Pyramis' / Fidelity's hundreds of analysts and then builds a portfolio that is sector-neutral, region-neutral, and generally characteristic-neutral (P/E, P/B, growth vs. value style, etc.) as the EAFE index, but comprised of the companies in each sector with the highest expected returns. This manager was first funded by CalPERS on 4/1/08 as part of the global equity rebalancing and has outperformed by 1.82% through the end of the fiscal year.

Quantitative Management Associates International

QMA was hired by CalPERS in April 2006 to manage an enhanced index portfolio. QMA's investment process uses a quantitative approach to exploit persistent, predictable mispricings. QMA classifies stocks by historical and expected future growth rates, then uses a variety of models which use the expected growth rate to extrapolate a predicted future performance for each stock. Finally, an internally developed optimizer is used to construct the portfolio with the maximum expected return, subject to some risk constraints. Targeted tracking error is 2%. Through fiscal 2007, QMA had returned 198bp better than the benchmark on an annualized basis, but very poor performance in 2008 (-2.99%) due to the same factors as many of the other quantitative managers pushed the since inception return down to -0.63%. As with many of the other quantitative managers, performance appears to have stabilized since March, and the manager has returned in-line with the benchmark.

Conclusion

As in last year's report, where three managers performed poorly enough to warrant special attention or scrutiny (two of those three have since resigned), Wilshire believes that the continued underperformance make several managers candidates for review by Wilshire and Staff.

Through the on-going activities of both CalPERS' consulting team and Wilshire's Manager Research Group, we closely monitor the performance and investment processes of all of CalPERS' managers. At this time, Wilshire concurs with Staff's recommendation to renew the contracts for all of the international equity managers, as CalPERS still has the right to terminate any of these managers with 30 days notice.

Sincerely,